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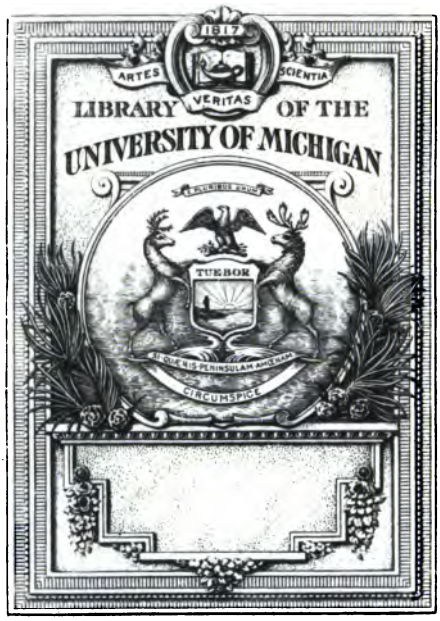
WHAT SHALL BE DONE WITH ASSESSMENT INSURANCE?

GEORGE DYRE ELDRIDGE.



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What Shall Be Done

WITH

ASSESSMENT INSURANCE?

GEORGE DYRE ELDRIDGE

PRINTED FOR THE AUTHOR
NEW YORK
1899

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WHAT SHALL BE DONE WITH ASSESSMENT INSURANCE?

I.

REFORM—DESTRUCTION.

The rights of three million policy-holders —mostly heads of families—are involved in the settlement of the questions affecting Assessment Life Insurance.

Although an effort is made to-day to distinguish between business and fraternal organizations, the fate of the former once settled, there is neither power nor logic to save the other.

In this matter, where all admit the need of change, there are two parties. The watch-word of the one is "Destroy;" that of the other "Reform."

Men whose business it is to legislate must make choice between the two. To avoid the one, the other is inevitable.

The writer of these pages stands for Reform. The evil complained of is that a portion of the policy-holders in Assessment companies have lost their insurance and their premiums paid through the destruction of the companies. To save others from the same fate, certain men cry out for the destruction of all the companies that remain.

Ten men have died in a hospital from small-pox. Kill the other ninety by process of law, to save them from the possible fate of their companions!

It is the purpose of these pages to point the way to Reform. It does not require either thought or study to point the way of Destruction. Even a fool, unguided, can find that.

II.

THE ARGUMENT FROM FAILURES.

The press chronicles every disaster and makes a sensation out of every failure.

The quiet routine of fulfilment of obligations finds no sensational chronicler.

Two great failures of Assessment companies—failures that were well-nigh criminal in their needlessness and in the suffering and disappointment wrought—have occupied the public eye for two years.

The advocates of destruction have sought to make it appear that these failures mark the end of all insurance, save that conducted by the other class of companies.

So intent have they been to this end, as to lose sight of the $100,000,000 in death claims paid by Assessment companies during these two years.

Does the crime of two or a dozen needless failures call for the destruction of a method of insurance under which more than $800,000,000 have been paid to widows and orphans?

Common sense suggests that the machinery by means of which such results have been accomplished is too valuable to be lost.

Shall we go back to stage-coaches, because an accident on a great trunk line occasionally brings loss of life and property?

Thirty years ago, the oldest American companies operating on what is now known as the Legal-Reserve or Old-Line plan were about as old as are now the oldest Assessment companies.

The press was then quite busy chronicling the failures of these so-called old-line companies.

Fortunately, modern practice had not reached the refinement of killing the patient for fear he might die, or some one might have suggested the prohibition of all life insurance.

The press comments aroused by these failures were as bitter as have been those since occasioned by the failures of Assessment companies.

Neither in the one case nor the other are those comments safe guides, for naturally they are the result of passion and the excitement of the moment, and not of that cool judgment which should govern in a matter of this moment.

In September last, Hon. John A. McCall, the honored former Superintendent of the New York Insurance Department, and the

now no less honored President of one of the greatest of American Life Insurance companies, read before the National Convention of Insurance Superintendents and Commissioners a review of the history of life insurance, and in his words may be found a calm—and certainly not hostile—statement of facts:

"The nine years immediately following the First Convention (1871) must be accounted the most trying period in the history of American Life Insurance. The number of companies which ceased doing business in New York was forty-six. Only four re-insured in companies that remained solvent; only ten others paid their liabilities in full. Receivers' reports are incomplete, but a careful examination of such as are accessible show the total loss to policyholders by failures among American companies to be about thirty-five million dollars. * * *

"Meanwhile the waste and extravagance of receiverships went on until they became almost as great a scandal as the mismanagement of companies that had brought them into being. * * *

"The Legislature did but little to protect the interests of policy-holders, and the ill-timed denunciation of Life Insurance indulged in by some of its members often failed to discriminate between well- and ill-managed companies, and so added to public distrust. * * *

"The loss, to solvent companies, of business as well as *prestige*, during this period, was very great. In 1870 the income of the companies doing business in New York was $105,000,000, in 1879 it was $76,000,000; in 1870 the new business was $588,000,000, in 1879 it was $168,000,000; in 1870 the risks in force were $2,024,000,000, in 1879 they were $1,440,000,000.

"Notwithstanding the removal of so many competitors from the field, the business of the thirty-one solvent companies was less in 1879 than that of the same companies in 1870; their income was two millions less, their risks in force were seventy millions less, and their new business had fallen off over one-half. * * *

"It has been the custom of writers who would exalt Life Insurance to give scant space

to the discussion of the failures and losses of this period; but to my mind there is no period in Life Insurance history that deserves more careful study, and none that contains more valuable lessons to the life insurance manager. * * *

"In 1879 the epidemic of failures which had set in nine years before had run its course; the patients were nearly all dead, and the business of the remaining companies began to improve. * * *

"No one but those who were familiar with the business in those troubled years can realize how hard the struggle was, nor how much effort was required to regain lost ground. * * *

"Not until 1886 was the insurance in force of companies doing business in New York as great as in 1872; not until 1887 was the total income as large as in 1873; and not until 1888 was the new insurance as much as in 1869. It took from fourteen to nineteen years to repair the losses which life insurance suffered by reason of commercial depression and internal mismanagement." *

* From "A Review of Life Insurance" by John A. McCall, September, 1898.

Here are the words of a brave man who is not afraid of facts.

Only cowards will plead a set of facts to aid them in destroying that which they oppose; and at the same time hide from sight exactly duplicate facts in connection with a cause which they sustain.

III.

WHAT PROHIBITION MEANS.

Legislation cannot prevent failures. Practically, the laws that are now in force for the regulation of legal-reserve insurance were in force when more than one-half the existing companies failed in the early seventies.

Regarding the efficacy of remedial legislation then adopted, Mr. McCall says, "The value of these measures of relief will be apparent when I say that a failure involving a very heavy loss to policy-holders occurred in 1883, several years after the last law mentioned was enacted."

Legislation, if it proceeds on wise lines, may, however, vastly diminish the chances of failure and of the loss that is thereby involved.

Destructive legislation—prohibition—simply makes certain that failure which is only possible; and compels policy-holders to sustain a loss which they might be spared.

No friend of Assessment Insurance; no advocate of the right of the people to have preserved the good in the system, will fear to face the ugly facts in its history, or will deny the need of radical changes in the legislation which regulates it.

No friend of the people; no true friend of Life Insurance; will ask for legislation which relegates the entire practice of life insurance to a single standard, and that a standard of which the warmest defenders admit that it is inequitable; that it does not take account of facts; that it is antiquated; that it is dangerous.

Prohibitive, in place of remedial, legislation, means the monopoly of life insurance under a standard that admittedly is full of defects.

What are the defects in existing legislation on the subject of Assessment Life Insurance?

This question answered, is it wisdom to heed those who from a study of the subject point out the remedies; or those whose interest in monopoly leads them to deny the existence of remedies?

Are constituents who seek protection at the hands of legislators apt to be satisfied, permanently, if those legislators lend themselves to the schemes of wreckers and bring about the very disaster against the possibility of which the public ask to be shielded?

The sum of the disasters which can happen through Assessment Insurance is the loss of the insurance carried in these associations and the loss of the money paid to them.

The advocates of prohibition are asking, at at the hands of the legislatures, that this loss be made certain. They will be satisfied with nothing less.

To grant their demands means $50,000,000 in death-claims unpaid next year and the year after that and the year after that. It means $500,000,000 taken from the widows and orphans of present policy-holders in the next ten years.

IV.

PROPER CONDITIONS OF ORGANIZATION.

Assessment legislation consists of two parts:

1. That which provides for the organization of companies and associations;

2. That which provides for their regulation and the conduct of their business after organization.

The evil began with the first part, in shameless disregard of every precaution which should attach to so important a grant of franchise as that for the conduct of a life insurance company.

In extenuation, it may be said that almost no one at the time of the formation of these laws recognized what was their purpose.

In other cases, legislators were besieged with protests against recognizing the new movement and the privilege which was withheld from the public, in compliance with such protests, was obtained under laws originally designed for entirely different organizations.

Thus any one could obtain a charter upon

complying with the most trivial conditions; and organizations multiplied like drops of rain in a summer shower.

There is absolutely no reason why the obtaining of a charter to do a life insurance business on the one plan should be any easier, or should require lesser guarantees, than when the business is to be conducted on the other plan.

Make the conditions under which business may be done on the one or the other plan as conducive to absolute security as possible, and then apply the same restrictions to the granting of the one charter as of the other.

A DEPOSIT WITH THE STATE which grants the charter is mainly valuable as attesting the good faith of those who seek the charter; and as affording security that current obligations will be met in the formative years.

It is not its function to afford in itself security for the mass of business that success will bring. It is sure, in event of such success, soon to be overshadowed in amount and to become insignificant in comparison with the accumulations derived from the business.

No charter should, however, be granted with-

out requiring such a deposit, and, at least in the Eastern States, the sum of $100,000 is not an exorbitant amount.

In the new States, and those which are less the centres of capital, a smaller sum might be permissible, but certainly no life insurance company should be admitted to business in a State other than that of its incorporation unless it is possessed of funds, either deposited by its corporators or accumulated from its business, of not less than $100,000 in amount.

If provision is to be made through a general incorporation law for the chartering of life insurance companies, the New York statute affords a fair model as regards stock, or proprietary companies; while the interposition of a temporary guarantee capital, somewhat on the line of the special charters under which the mutual companies of Massachusetts were built up, will point the way in the case of mutual organizations.

To repeat: *if there is no general law for the incorporation of the one class of life insurance companies, there should be none for the other. If there is a properly stringent law for*

the general incorporation of one class of companies, there is no reason why the other class should be exempt therefrom.

V.

MUTUAL OR STOCK?

There is nothing inherent to the nature of Life Insurance that requires it to be conducted under a mutual form of organization.

In fact, the mutual form of organization, so far as new companies are concerned, has long since given place to the stock or proprietary form, and in very few States is there to-day any provision of law for the organization of the former, while in almost all the States there is provision under which capital can engage in the business of insuring lives—a business which the law almost renders it impossible for the people to engage in for themselves.

It is generally held that the upbuilding of a new company under the present legal-reserve law will cost from a quarter to a half million dollars, with the chances greatly against success.

"At the end of 1868, when the law was beginning to be enforced closely, there were doing business in New York twenty companies organized after the war, and of these every non-industrial company, that is to say, all of the twenty except the Metropolitan, failed. In 1869, nine more new companies began to do business, every one of which failed. In 1870 and 1871, four or five more new companies began business, all of which failed. * * *

"To sum up this remarkable history, all non-industrial companies doing business in New York prior to 1875, to which the net valuation law was rigorously applied during the first few years of their existence, failed. * * *

"The well-known practical impossibility of establishing a regular life company under a rigorous enforcement of the net valuation law remains unchallenged by any example to the contrary." *

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* Emory McClintock, on "The Life Companies of Thirty Years Ago—What Became of Them," in the United States Review, December, 1898.

If, therefore, life insurance can, by prohibitory legislation, be reduced to this one plan, it means practically that the entire life insurance of this country will be concentrated in the hands of the existing fifty old-line companies, which by the destructive measures asked for will be relieved as well of the competition of the existing mutual or assessment organizations.

These fifty legal-reserve companies now control $1,500,000,000 of accumulations. Twenty-eight years ago, just as Assessment Insurance began its growth, the legal-reserve companies controlled but $275,000,000 of assets.

Relieved of all competition, with business restricted to the one plan, what will be the amount of accumulations under their control twenty-five years from now?

It is in no sense a reflection upon the men who have built up these great moneyed institutions—men who have every reason to be proud of the success they have achieved—to believe that such prospect of control of vast sums in the hands of a few corporations has its

attraction and its effect upon their judgment.

The number of companies existing to-day under the legal-reserve plan is smaller than a quarter of a century ago. Within the next quarter of a century, there is more apt to be a reduction than an increase in the number, so that the vast life insurance business of the land in 1925, with its almost immeasurable accumulations, will probably—if the policy of destruction in place of reform in Assessment Insurance prevails—be in the hands of less than fifty corporations.

VI.

PREJUDICE AGAINST PRINCIPLE.

The Assessment legislation of fifteen and sixteen years ago aimed mainly to embody in statutory law the methods of business then prevailing.

It took no account of principles which underlie Life Insurance, but sought to regulate in the simplest manner a business that had grown already to vast magnitude.

Assessment Life Insurance had its birth in

the wish of the masses for the benefits that Life Insurance alone can give and in the belief of the people that it was costing too much and was lacking in security as practiced by the old-line companies.

The disasters of the period, during which more than half the companies of the country retired from business, were fresh in the minds of deluded and disappointed policy-holders.

"There is no question but that many co-operative and fraternal societies operating between 1870 and 1880, in spite of their imperfect system, and because of honest management, furnished better protection to their patrons than the level-premium companies whose demise we have been considering—although the latter were organized upon plans that were unassailable, ran their course of wickedness under the ægis of the law, and died in the odor (a very bad odor, to be sure) of regularity. While the business of the level-premium companies that failed was but a small percentage of the whole, and there were always sound and well managed companies in the field, yet the losses were nevertheless great

and widespread, and it was little comfort to one who had lost the accumulations of years to be told that he should have insured in a better company. A system that furnished (or even promised) present protection at low cost, and did not profess to accumulate money for future needs, appealed very strongly to men who did not understand theories of insurance, but who who were angry and sore at heart over losses under a system that professed to be perfect." *

The people took counsel of their prejudices, and believed that they could throw principles to the wind.

To-day, simply because similar disaster has occurred to some of the newer organizations, prejudice is again called to aid those who would destroy.

There is no more regard for principle in the one course than in the other.

The method of common sense would be to enquire what is lacking in the original laws and supply the deficiency.

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* From "A Review of Life Insurance," by John A. McCall, September, 1898.

The practice of the business has outgrown the law and is far sounder to-day than when the law was made. The law remains practically unchanged.

The old disasters grew out of the old methods, long since discarded so far as new business is concerned; but when this plea is urged, the answer is that the new methods were not contemplated by the law and that, *therefore*, they are illegal.

The statement of fact is true. The "therefore" which follows is sheer nonsense. If the law perpetuates evils of practice that the associations seek to discard, the law should be amended.

The object of a law is always more important than the mere words that make up the law.

VII.

NON-ACCUMULATIVE INSURANCE.

Men saw in the failure of old-line companies that the policy-holders lost not only the insurance which they had attempted to purchase, but, as well, the money accumulated

from their payments, which was to help pay for future insurance.

They decided that at least they could save, in case of failure, this accumulated excess, by paying only the cost as it accrued, thus avoiding all accumulation.

They failed,— and the law followed blindly where they blindly led,— to take account of this one fact:

THE COST OF LIFE INSURANCE INCREASES WITH THE CHANCE OF DEATH, AND IF IT IS TO BE PAID AS IT ACCRUES, THE PAYMENT MUST INCREASE AS THE COST INCREASES. IN NO OTHER WAY CAN ACCUMULATION BE AVOIDED.

This is law already made, founded in unalterable facts. The companies should of their own accord have conformed to its requirements. When they did not, *statutory law should have compelled such conformation*, as a condition of the right to do business.

The compulsion which should have been in the law from the first, should be placed there forthwith.

To do this requires,

FIRST: *The adoption of a standard by which the relations of cost between different ages shall be measured:*

SECOND: *An amendment to the law providing that no life insurance company shall give or contract to give life insurance for a less sum in hand, exclusive of expense money, than the cost, as determined by such standard and the actual age, to the date when the next premium is payable.*

If a company under this law sold life insurance for just the sum which represented the cost by the standard to the next date at which a premium became due, it would be selling life insurance as absolutely without accumulation as can possibly be done.

The company would have in hand—of money paid for and held to meet the death-cost—simply the amount of that cost to the day when the contract and the risk must cease if a further payment was not made. If the actual cost conformed to the pre-calculated, on that date there would be nothing left. If it

was less than the pre-calculated cost, the excess would constitute a surplus protection to a certain minimum amount above which it could be made a credit on account of the next increased payment.

The New York Stipulated Premium Law, with an amendment compelling the annual advance in premium rate and permitting reduction therefrom only after there has been accumulated, in addition to the unearned premium, from the member's actual payments, a sum equal to the standard cost for one year at attained age, affords a good model for dealing with this class of insurance.

Under such a contract the rate of payment by each policy-holder would be advanced as he passed from one year of age to the next higher.

THE STATE SHOULD NEVER HAVE PERMITTED LIFE INSURANCE WITHOUT ACCUMULATION UNDER ANY REQUIREMENT AS TO PAYMENT LESS THAN THIS.

VIII.

THE PROPER USE OF ACCUMULATIONS.

It is not a question whether, under such a requirement, Life Insurance without accumulation would remain practically possible.

The State has no right to permit Life Insurance under conditions less than safe; and the above-named condition is the minimum under which Life Insurance without accumulation is safe.

Probably, excepting for a comparatively small amount of business covering needs recognized from the beginning as temporary in character, Life Insurance absolutely without accumulation on these terms would prove unattractive.

Indeed, absolutely non-accumulative Life Insurance can cover only a very narrow field, particularly among a people who have for a generation or more been fed upon tales of the *investment* nature of Life Insurance.

It held its place only because in the absence of law it was possible for a very considerable period to avoid the increase in price

from age to age which is necessary to equity and fair dealing under this form of insurance.

As the law of increase in cost made itself felt with increasing force—as in the absence of accumulation it was bound to do—the tendency of Assessment Life Insurance, towards rates providing for accumulation and in the direction of permanent uniformity, has steadily increased.

The cowardice of managers of companies, who have refused to protect the accumulative portion of premium payments on new business against misuse by application to meet the deficiencies of payment on business paying non-accumulative rates, has too often rendered these advanced rates simply a temporary delusion and the initiatory step to new disappointments.

When new business is placed upon a rate which pays more than immediate cost, it is for the purpose of providing for those paying such rate, through accumulation, means of meeting future natural increase in cost.

It is not and, honestly, it cannot be for the purpose of enabling the association to continue

to furnish to those who are paying non-accumulative rates life insurance at less than cost.

Yet, through the ignorance and cowardice of managers, this is exactly what has been done in the great majority of cases; and, through the ignorance or greed of the policy-holders, where it has not been done, but where, instead, there has been an honest purpose to distribute properly actual cost, a cry of indignation has arisen and the forces that should sustain the management in its course have been appealed to to destroy.

Every legislature will be told by those whose cry is "*Destroy*" instead of "Reform," that old policy-holders who were paying non-accumulative rates for their insurance, have been called upon for increased assessments.

Had the law been what it should have been from the start, instead of the managers of a few companies having the courage to do what is right and brave the storm that it called forth, the managers of all companies carrying non-accumulative Life Insurance would have been COMPELLED *equitably to distribute cost, and the scandals of the failures that have shaken public confidence could have been avoided.*

To employ the surplus payments of policy-holders who are paying more than current cost for their insurance, to make good deficiencies in payments of other members who are paying less, is as unwarrantable a misuse of funds as the appropriation of the same money to any other purpose, other than that for which it is collected, would be.

Yet this is just what has been done for years, through the ignorance or cowardice, or both, of company managers; *and the State, by its loosely drawn laws, has been a party to the wrong.*

IT IS TIME THAT THE STATE WITHDRAW FROM THIS PARTNERSHIP OF EVIL.

IX.

PAYMENTS ABOVE COST MUST BE RESERVED.

To this end, the State should require the reservation, for the credit and use of the payer, of any payment—other than expense payments—in excess of the standard cost of the particular insurance on account of the cost of which such payment is made.

In other words, as the policy-holder who pays simply the current cost of his insurance as it accrues, pays it in accordance with a certain standard of cost and enjoys any saving from that standard cost, so the policy-holder who pays for his insurance by paying for the time being in excess of such standard cost should be required, from this greater payment, to contribute to current cost the same sum that the other policy-holder contributes at the same actual age and for the same actual amount of insurance, and the balance of his payments should in honesty be held in reserve for future use by himself.

Unless this is done, either by requirement of law or voluntarily on the part of the company, equity in cost, between policy-holders who make payment on account of cost in differing manners, cannot be secured.

Unless this is done, either by requirement of law or the voluntary act of the company, the company should be restricted to a single method of collection of cost, to be applied alike to all of its policy-holders.

When it is done, in the one way or the

other, the company may be given full liberty in the matter of the employment of varying methods of collecting cost.

As this is a law inherent to the very nature of the transaction, the statutory law regulative of the business should express it as a requirement.

The excess of the payments actually made by a given insurance, together with the interest thereon by the common standard, over those which would have been made by an insurance of equal actual amount, carried at the same age, which had paid only the current cost by the minimum standard, constitutes the NET VALUE *or* RESERVE *on account of that insurance, and is the sum that must be held to the special benefit and credit of that insurance in order to preserve equity between policy-holders.*

The State must require the recognition and conservation of this reserve or net value, if it would absolutely dissolve the partnership of evil into which it has entered with cowardly or ignorant managers of companies, who have diverted the over-payments of one portion of the policy-holders to the perpetuation of the under-payments of another portion.

X.

THREE PRINCIPLES.

Three principles necessary to the *reform*, as distinct from the *destruction*, of Assessment Life Insurance, have thus far been established as demanding incorporation in any just and efficient law for the regulation of the business:

I. *Non-accumulative life insurance is to be required by law to pay the annually increasing cost as determined by a State standard:*

II. *No company or association is to be permitted to contract for or to give life insurance upon a less payment, exclusive of expense payments, than is required by such standard:*

III. *Where the payment on account of cost, exclusive of expenses, is in excess of the minimum, such excess, together with interest by the standard rate, must be held in reserve for the especial benefit and credit of the insurance on account of which it was paid.*

XI.

WHERE THE PLANS SEPARATE.

The enforcement of these principles, on the basis of any standard which is sufficiently stringent to render it safe, will secure equity, since all payments are treated uniformly and in accordance with the one standard, and if surplus arises or deficiencies occur—under a contract which like the assessment contract permits repair of deficiencies—these, too, are measured by the one standard.

Accumulative payments, however, have a distinct purpose and that is

The maintenance of uniformity of actual payments, as distinct from natural increase in cost, either for life or for a stated term of years.

The valuation of a legal-reserve, or "old-line" policy of insurance is directed to two ends:

I. *The reservation, to the especial benefit and credit of the particular insurer, of his own surplus payments above the minimum required by the valuation standard:*

II. *The determination of the sufficiency of*

such reserve to the maintenance of uniform payments absolutely limited in amount and to the fulfilment of the contract.

Only the first of these is covered by the principles already established and the changes in the existing law necessary to the enforcement of those principles.

At this point, for the first time, there enters into this discussion the essential and foundation difference between legal-reserve, or "old-line," insurance and Assessment Life Insurance, where each is based on equally sound practice and equal fundamental principles.

Legal-reserve, or old-line, insurance—using the term in the absence of a better one—*establishes a maximum premium, confessedly in excess of that which will be required, and agrees to reduce actual payments to actual cost by the ultimate return of earned surplus:*

Assessment insurance—still employing an inadequate term for want of a better one—*establishes a premium indicated as sufficient by experience and agrees to reduce actual payments to actual cost by the ultimate return of earned surplus,* BUT FURTHER RESERVES THE RIGHT, IF

ULTIMATE COST SHOULD EXCEED THE PAYMENTS ON THE PRE-DETERMINED SCALE, TO REPAIR THE DEFICIENCY BY CALL FROM THE POLICY-HOLDER.

Briefly, the two methods may be designated as those of,

I. MAXIMUM PREMIUMS, *with pre-determined limit of cost or premium obligation;*

II. MINIMUM PREMIUMS, *with pre-estimated limit of cost and elasticity of premium obligation.*

To both, the two principles of minimum payments and reservation of actual excess payments apply alike, and to this extent the standard employed in the one case should be employed in the other.

As regards the third principle, that of the determination of the sufficiency of the provision made for maintaining uniform payments either for life or a given number of years, the two methods present entirely different conditions.

XII.

THE STATUTORY STANDARD AND ITS USE.

The general insurance law gives statutory authority to one of several standards on which life insurance may be conducted.

It does not *create* the principle of reservation of surplus payments; for that is a requirement of equity. It simply names a standard by which shall be determined, during the pendency of the contract, the individual surplus payments made by each insurer, at the same time admitting that such determination is not final, since the element of an accumulated surplus fund, in which the policy-holders have a general and undivided ownership, comes in for subsequent division or use within the discretion of the management of each company.

The main requirement of such a standard is that it shall be sufficiently stringent, and for the uses to which it is put in this regard, the defects of the Actuaries' table rate of mortality—now very generally adopted by the several States—do not, to say the least, impair its value. The principal defect is that it presents an excessive mortality rate.

When employed—as is herein suggested—to determine the minimum premium, for the period for which full payment is made in advance, at which insurance may be sold, this defect is also in no sense objectionable.

For the performance, therefore, of the two functions common to both methods of insurance, viz.: The fixing of the minimum premium for the period for which an insurance is wholly paid for in advance; and for determining from time to time the interest which each insurance has in funds accumulated from past payments, there is no serious objection to be urged to this table, coupled with such a rate of interest as from time to time may be fixed by law.

Both assessment and old-line insurance may well be required to comply to this extent with this standard.

XIII.

THE STATUTORY STANDARD INAPPLICABLE IN CERTAIN REGARDS.

When, however, we come to the function of determining the sufficiency of a predetermined premium to the performance of the task to which it is addressed, and that with such a degree of certainty as thereby to fix a limit to the obligation of premium payment resting upon the policy-holder, with the destruction of the institution as a result of the breaking down of the calculation, a far more complicated question arises.

Life insurance contracts are written daily, the completion of which may occur much more than a half century hence.

Who has the ability or knowledge requisite to foremeasure all the hazards, all the contingencies, all the changes to which such a contract will be subjected?

Much less, who has the power so accurately to make such foremeasurement as to say that a certain standard—and one standard only among many—is sufficient and safe and will remain sufficient and safe?

Yet this is practically what this part of the legal-reserve law assumes to undertake !

In other words, the fundamental assumption of the law is that, only on the basis of the Actuaries' table rate of mortality and interest at the rate of 4 per cent. per annum, is a company justified in contracting for insurance and limiting by a definite sum the obligation of the policy-holder to make premium payments.

Such being the case, the company must, under such a contract, reserve as if it were collecting a premium of at least this assumed necessary sum, because on such an assumption the natural law of reservation points to this as the standard of reservation. If, under such a contract, the company is not collecting this assumed necessary premium, or if it has released the policy-holder from the obligation to pay any part of it, it must make good the present value of the deficiency—whether present or future—from some other source.

The logical conclusion of this form of reasoning is that the existence of this reserve, so determined both as to the present and the future, is a test of solvency.

The soundness of this conclusion has been questioned by almost every authority on Life Insurance, and the tendency to question it is steadily growing, but that question does not enter into this discussion, for the simple reason that

THE FORM OF CONTRACT UNDER CONSIDERATION IS NOT ONE TO WHICH THE VALUATION BY THE STATE STANDARD AS A TEST OF SOLVENCY APPLIES OR CAN EQUITABLY BE MADE TO APPLY.

When a company, under whatever name, issues a contract under which it limits by a predetermined sum the obligation of the policy-holder to make future premium payments, under existing laws it must be held to the requirements as to reserve to which the legal-reserve companies are held, and modification of this law can come only through modification in its application to all so-called legal-reserve companies.

This discussion relates solely to the determining of the requirement as to sufficiency of reserve for the future, to be applied to contracts under which the right is reserved, in case of need, to call for a premium in addition to the regular

stated premiums, or to increase such regular stated premiums.

To such a contract, the rule established by the existing State standard of valuation—in its prospective aspect — is inapplicable.

The two things do not fit together and only by violence can be made to fit together. If the rule is applied, then the contract is destroyed, and the two methods of insurance are merged into and made one. It is right here where lies the distinctive line, which if regarded and preserved will give the public competition between two separate methods, each amenable to its proper regulations and requirements and each conforming to the necessities of security as developed under the proper contract conditions.

XIV.

THE STANDARD OF COMPLETE VALUATION.

This non-application of the rules of insurance valuation which are applicable prospectively to the old-line contract, properly means, not ABSENCE, *but* ELECTION *of a valuation standard.*

The absence of provision for such election is one of the glaring defects of the present law, which should be corrected in the interests of security and fair dealing with the public.

The State standard is only one of many that are equally safe, logical and well sustained.

Every premium, which is to remain level for a period exceeding a single year of life, must be based either on guesswork or on a standard, the foundation of which is demonstrable.

GUESSWORK SHOULD CEASE.

To a very marked extent, as regards rates of premium now in use, it has disappeared, in spite of the silence of the law.

Now the law should step in and end it for future business altogether.

The basis of premium-construction of every net premium, which is to remain level either for life or any term of years, furnishes the factors for determining if the fundamental conditions of the contract are being carried out and whether the actual experience so far conforms to the original assumptions, in accordance with which

the standard of premium-construction was selected, as to confirm the sufficiency of the premium to the end to which it is addressed.

In other words, the factors which enter into the construction of the net premiums, are the factors from which valuation is to be made and the amount of reserve necessary to be held is to be determined from time to time, exactly as under the State standard the Actuaries' table rate of mortality, and interest at four per cent., are the factors employed in valuation to determine the future sufficiency under the State standard.

The law should, therefore, require every company to establish its premiums, when they are in excess of the legal minimum, upon a demonstrably secure basis and to set forth to the Insurance Department the basis employed and the reserve accumulations for the future, requisite to the fulfilment of the contract and the maintenance of the scale of premium payment as pre-calculated.

THE MAINTENANCE OF THE RESERVE THUS INHERENT TO THE BASIS OF PREMIUM-CONSTRUCTION SHOULD BE MADE BY LAW THE TEST—NOT

OF SOLVENCY—BUT OF THE NECESSITY OF BRINGING INTO ACTION THE RESERVED RIGHT TO CALL FOR AN INCREASED OR ADDITIONAL PREMIUM.

Thus an impairment of the reserve becomes the signal of danger, which may be avoided; not the announcement of approaching dissolution, to be made complete through the medium of a receivership.

XV.

ACTUARIAL OPINIONS.

The conclusions reached are radical only in so far as they are novel and run counter to the education of a generation and a half that has taught our American people to regard the State standard of valuation as a guarantee of solvency and the only guarantee of solvency that exists.

The State does not guarantee solvency; it simply tests it. The test which has been erected in law is only one of many, but it has been applied as if it had universal power and application.

Of it, the Actuary of a strong old-line company recently wrote:—

"Would it not therefore be better, without mincing words, to admit the inevitable conclusion, that the first direct attempt to establish a basis of valuation of life insurance contracts in this country was merely a crude effort on the part of the lawmakers. In ignorance of the scope of their undertaking they essayed to establish an arbitrary basis of company liability, at a time when the business was practically in its infancy; when its exigencies and the lines upon which it would develop were but little known and comprehended; and therefore such efforts were but little more than purely experimental. * *, *

"Out of all this has grown a kind of fetich, the worship of which has acquired such unreasonable ascendancy over our intelligences (by reason of the sanction that custom seems to have given it) as to successfully warp the judgment of many of the brightest minds in the life insurance and actuarial professions. It almost seems as though an odor of sanctity has been thrown around this fetich, so that one would justly deserve rebuke for daring to call it into question or seeking to analyze it."*

* Wm. T Standen on "Net Premium Valuation," in the Insurance Press, Dec. 28, 1898.

A comment of one of the most prominent consulting actuaries of the country has a bearing also upon the soundness of the measure herewith proposed:—

"It is quite probable that had the companies taken the precaution to have provided definite contracts nothing would have been heard about statutory valuation here, any more than in Great Britain, where public confidence in corporate righteousness is greater than in most new countries. * * *

"These laws were instituted indirectly to protect the insured from the abuse of defective contracts, and I believe the better plan would still be to make them applicable *only* when the policy was silent in above particulars. This would set competition to work to *decrease* the margin reserved for expenses and *increase* that for accumulation, whereas competition at present works just the reverse. In this way companies could be left to freedom of contract, as in England, without further interference than, perhaps, a liberal solvency test."*

* Wm. D. Whiting, in The Insurance Monitor, December, 1898.

As to the original and legitimate purpose of a State standard of valuation, and as forming a basis of judgment of the degree to which the same thing is accomplished by the suggested requirement set forth above, the following is important:

"The system of net valuation is in no sense a final or complete test of solvency. It is rather a means of demonstrating that the fundamental conditions governing the business have been faithfully observed and carried out. In other words, that the portions of each annual premium intended to provide respectively for mortality, expenses, and reserve (or deposit for investment) have sufficed for their respective functions, and that the last-named portion has actually been laid aside and been added to the reserve for the end of the preceding year." *

As marking the conservative character of the conclusions reached in these pages, one among numerous quotations that might be made must suffice:

* Sheppard Homans, Remarks at the International Congress of Actuaries, 1895, Papers and Transactions of Actuarial Society of America, Volume IV.

"The energies which in this growing country might have been turned toward the establishment of new and prosperous life insurance companies were directed by this reserve difficulty into another channel, and a great cry arose for life insurance without reserves. * * *

"What is the remedy? * * * Make no attempt to enforce State valuations. Repeal all laws assuming to regulate contracts. On the other hand, require of every society absolute publicity concerning the essential elements of its accounts, including its reserve valuations. It is many years since I first had occasion to express my opinion on this subject. My advice then was given in two words, in which I sum up my advice now: Freedom and publicity." *

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* Emory McClintock, at the Convention of Insurance Commissioners and Superintendents, Milwaukee, September, 1898.

XVI.

AS TO PRESENT BUSINESS.

The principles to be embodied in a law under which Assessment Associations may with safety be permitted to continue business are:

I. *Minimum Premiums, determined from the State Standard;*

II. *Reservation of actual surplus payments, determined by the State Standard;*

III. *Determination of the sufficiency of the reserve by the standard of premium construction;*

IV. *Enforced application of the reserved right to increase premiums in event of impairment of reserve.*

Under such requirements, there could be no shilly-shallying; no dodging of unpleasant responsibilities to the end of avoiding the exaction of sufficient premiums; no carrying of policy-holders who are paying inadequate rates under one scale by defrauding those who are paying in accordance with a higher scale.

It would have rendered impossible the conditions which wrecked in 1896 the two largest Massachusetts associations.

The same principles, thus developed with relation to new business, are the governing ones under which existing business in these associations should be treated.

Such existing business is easily divisible into certain groups to which are applicable either all or a part of the four principles enumerated above, the first and fourth being applicable to all the groups. The following specified groups will cover all such business:

I. Policies or certificates under which the cost is payable through assessments or calls to meet accrued claims (post-mortem assessment policies); including all contracts under which there is no accumulation other than the single call, now required as an "Emergency Fund" under the legislation of most of the States.

To this mass of business the first and fourth principle would apply. The reserve would be simply the amount necessary to meet standard cost to the date of next premium payment. The equivalent of this would

be the standard premium necessary to cover the cost of the insurance to the end of the policy year, less the net assessments collectable within the same period.

II. All policies under which a stated premium is payable, which premium is in excess of the standard premium for age of issue, which premium is still in excess of that called for at attained age. If not still in excess, these policies would fall under group "I."

If these policies are paid for by premiums designed to remain level throughout a term of years or for life, based upon a standard demonstrably sufficient, all four of the principles above named would apply.

If not based upon such a standard, then these policies would be treated as renewable term policies under the State standard, the term determinable by the actual net premium with relation to age of issue, the amount of reserve depending upon the number of years that has elapsed since issue. With the expiration of the term, these policies would renew under a corresponding premium for attained age, or fall into group "I." The first,

second and fourth principles would apply to these policies.

III. Policies under which the term of premium payment is less than the possible term of insurance—so-called "Limited Payment Policies."

To these policies all four of the principles enumerated are applicable. In the application of the third principle, the standard of premium-construction must be such as to accumulate at the end of the term of premium-payment the full net single premium at attained age, by the State standard, necessary to carry the insurance to the end of life; for the entire after lifetime now being the period paid for in advance, under the first principle set down, the minimum premium applicable becomes the State standard premium for life.

In general practice, unless the limited term of premium payment is very long, the net premium requisite under any acceptable standard would, necessarily, so nearly conform to the premiums required by the State standard as to make the variation at best but slight and unimportant.

A necessary prerequisite of authority to continue business under the amended law should be the advancement of deficient premiums to the minimum fixed by the State standard under the new law.

XVII.

FIRST YEAR'S INSURANCE.

To the end of avoiding all questions, the amended law should provide that when, by the terms of the contract, the first year's insurance is single year term insurance, it shall be treated as such for valuation purposes, regardless of the status of the contract after the close of such first year.

Unquestionably in case of a contest the terms of the contract would govern, but such a provision will remove all possibility of contest.

This treatment of the contract during its initial year accords with facts and has the support of the best actuaries of the world. It is especially applicable to this form of insurance, under which the reserve on account of pay-

ments made is determined by the excess of actual payments over the standard cost for the time for which insurance has been given.

On this point among the many authorities which might be quoted, the following are selected :

"The highest living authority, Dr. Sprague, of Edinburgh, called attention some time since to the fact well known in Great Britain, that the expenses of new business practically consume the first premium, and proposed that the reserve should begin to be accumulated out of the second premium. There is much to be said for this proposition, particularly in the case of companies newly organized, which have no assistance from any of the sources of miscellaneous profit which an established company possesses. * *

"While other causes were at work, the chief cause of the universal slaughter of small companies, which took place about twenty-five years ago, was the legal requirement of a reserve in the first year of each policy. * * *

"Had Dr. Sprague's proposal been available under our laws we should have heard com-

paratively little of assessment insurance with all its good and all its evil." *

"I can see no justification for continuing the present practice of the departments in charging the initial hypothetical premium in net valuations; and should it become necessary to change the rate of interest to 3 per cent., as seems probable, the relief afforded by considering the first year's insurance on all outstanding business as term, will be very welcome to those companies which have not held back dividends from policy-holders in order to accumulate large surpluses. * * *

"But the present statutes stand greatly in need of reform so as clearly to establish that the hypothetical premium intended is that which allows for a one year preliminary term, so that companies may adjust their methods to actual expense requirements." †

"In actual practice the first year's margins do *not* cover first year's expenses, and in no

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*Emory McClintock, at the Convention of Insurance Commissioners and Superintendents, Milwaukee, September, 1898.

† Wm. D. Whiting, in The Insurance Monitor, December, 1898.

case, upon first year's business, is the net first year's theoretical reserve in hand at the end of the first year. In other words, the net valuation system is not properly applicable to present methods of business. To charge in such case this purely theoretical first year's reserve against the policy is, to say the least, illogical. * * *

"In a paper read before the International Congress of Actuaries, held in Brussels in September, 1895, Thomas Bond Sprague, LL.D., formerly president of the London Institute of Actuaries, an expert of the very highest authority, condemned the usual method of charging as a liability the theoretical net reserve for the first year. * * *

"As there was no dissenting voice among the actuaries present, representing all civilized countries, it is to be assumed that Dr. Sprague's views were approved." *

"The object sought by you in the peculiar feature referred to is of course to avoid the technical liability for a theoretical net reserve

* Sheppard Homans, from paper printed in full in Report of Massachusetts Insurance Department, 1897.

at the end of the first year which is usually charged, but which under prevailing rates of expenses for new business is rarely if ever saved out of the first year's premiums." *

"I conceive that the relief can only be found (as so very many eminent authorities have pointed out) by regarding the present large cost of securing business, as a settled, indisputable and unavoidable fact; and imposing a first year's reserve *in accordance with facts*, and not in accordance with merely *partial and incomplete theories;* in other words, the reserve to be imposed upon a company at the end of the first year of the issue of a policy, should be consistent with all the facts which go to make up that contract and its procurement; and the law should not stultify itself by requiring a company to hold a reserve which the premium itself cannot by any possibility yield under present existing conditions." †

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* Sheppard Homans, letter to L. A. Cerf, July 23, 1896, published in The Chicago Independent, December, 1898.

† Wm. T. Standen, on "Net Premium Valuation," in The Insurance Press, Dec. 28, 1898.

"The method corresponds strictly with the business conditions of the companies in respect of the cost of procuring and maintaining their policies, and so conforms to what should be the true treatment of the companies by the State—that is, the testing of their solvency by the application of the mortality table and net rate of interest assumed by them in the construction of their own premiums and reserves, and the consideration of the exact terms of contracts made by them. * * *

"The valuation under discussion—first year temporary—subsequent years full or permanent—was proposed in 1870 by Thos. B. Sprague, late president of the Institute of Actuaries of England. Its theoretical assumptions and its practical conclusions have never been disputed by any competent actuary." *

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* Aug. F. Harvey, from letter to L. A. Cerf, dated Oct. 9, 1896, printed in full in The Chicago Independent, December, 1898.

XVIII.

GENERAL, PREFERABLE TO SPECIAL LEGISLATION.

Special legislation should never be resorted to where general legislation will accomplish the end sought.

There should never have been any legislation establishing special forms of Life Insurance such as is implied in the title Assessment, or Natural Premium or Stipulated Premium.

The regulation of all Life Insurance should have been by one statute the specific application of which would be determined by the form of contract.

To-day the reforms herein suggested can be better and more readily accomplished by amendment of the general law than by an attempt to remodel the special law for the regulation of Assessment Insurance.

The special law need be retained on the statute books only where the legislature refuses to amend the general law, so as to cover the transaction of all Life Insurance which can safely be permitted by the State.

If, however, the authority to do business other than under strict legal-reserve requirements, is to continue under a special act, the act regulating Assessment Life Insurance should be carefully and thoroughly studied and the amendments prepared to the end both of giving to corporations the required power under proper restrictions, and of withholding power where the proper restrictions are not complied with.

In either case, a date should be named in the future for compliance with the new requirements, giving a margin of time for the changes necessary on the part of existing companies, to shape their business methods to the new law.

Where existing companies, with rates of premium which meet the principles and requirements of the new law, are not possessed of the minimum fund of, say $100,000, but are possessed of invested funds sufficient to meet the outstanding accrued liabilities and the reserve computed on the basis of unearned premiums under the statutory standard, there should be fixed for such companies a minimum

deposit with a specified term of years during which such deposit may be advanced proportionately to the full sum fixed for general purposes.

In a word, the law, to the fullest extent compatible with public safety, should be made preservative and not destructive.

XIX.

FAULTS TO BE CORRECTED.

These pages are not written in extenuation or denial of wrongs that demand remedy. They are written in grim and earnest recognition of facts and with an honest purpose to aid in finding an honest cure.

They are written in full challenge, with the assertion that States which have, through inadequate laws, created institutions to which the people have trusted vast interests, owe something more to those interests than mere annihilation.

The men to whose hands were trusted the management of these institutions were many of them ignorant, but most of them were honest.

There has passed under their control within a single generation more than one billion dollars and of this fully $800,000,000 have found their way back to the widows and orphans of dead policy-holders.

Institutions which have accomplished this result have not been built mainly on a foundation of chicanery and pretense.

Admit the ignorance, but admit also that it has not been confined to one method of business, when of the foundation principle of legal-reserve insurance, one of its ablest exponents can say—without incurring contradiction—

"This system took some elements and functions of the premium into consideration, but utterly failed to consider other equally important elements and functions. * *

"Nevertheless, when the present conditions of the business so conclusively prove that the valuation laws are *not* capable of an equitable application as between old and new policy-holders at the present time, a *prima facie* case is made out *against* the heretofore prevailing construction. It is an old maxim that when the equity of a law fails the law itself falls. * *

"I think it is perfectly fair to assume that when this legislation was inspired, its authors worked in a very defective light, and with only a limited and circumscribed knowledge as to the conditions that would thereafter develop and prevail. * * *

"I think we would never have reached this condition but for the fact that, many years ago, the advocates of a gross premium valuation were so urgent, persistent and unquenchable. The best actuarial minds of that day, laboring for and desiring nothing but the good of the business, and wishing above all things that the life companies should be unquestionably sound, took refuge, in the other direction, in an alternative equally radical and unsound.

"As a mater of fact, the fundamental considerations which alone could have effectually justified the system of net valuation were never analagous to the conditions which governed and controlled the business; and in the confusion that inevitably results from such a condition of affairs, it would be very unwise for us to tie ourselves up too closely to our

past prejudices, or to decide that we could not consistently break through laws framed under an entire misconception of facts." *

Evidently Assessment Insurance has not secured a monopoly of the ignorance that has prevailed and the fallacies that have been embodied in law, any more than of the life insurance failures that have occurred.

The interests of the public demand, NOT THE RESTRICTION OF LIFE INSURANCE TO ONE SYSTEM OF PRACTICE, *but, instead,* THAT ALL SYSTEMS OF PRACTICE BE BROUGHT TO THE CLOSEST POSSIBLE APPROACH TO PERFECTION. *Then, through competition in excellence and strength, will the public be best served.*

These pages have nothing to do with the weaknesses of the so-called old-line or legal-reserve methods, *save as it is proposed to compel the people to purchase Life Insurance under that plan or go without it.*

Then it becomes a matter of interest to know that under that plan,

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* Wm. T. Standen, on "Net Premium Valuation," in The Insurance Press, Dec. 28, 1898.

I. *It is impossible to build up new companies;*

II. *Equity under present laws cannot be maintained between old and new members;*

III. *The foundation principle is the result of a crude effort, made when the business was in its infancy;*

IV. *Scarcely two actuaries to-day agree as to what a net premium valuation means;*

V. *The governing statutes stand greatly in need of reform.*

There certainly seems to be a good-sized beam somewhere, which may possibly interfere with the clearness of vision of those who enter the field to rescue the people from the evils of Assessment Insurance.

A somewhat greater degree of modesty; a trifle less distress over the ignorance of others; a less vigorous exercise of the lungs in denunciation of competitors, *might* be becoming in men who have so great a work of reform to carry forward in their own affairs.

XX.

A FINAL WORD.

There is no purpose in these pages to ask exemption from any necessary requirement.

There is no purpose in these pages to ask for the right to continue any unsound practice.

There is no purpose in these pages to deny the need of changes.

There is the purpose to ask the right to do a legitimate business under reasonable conditions.

There is the purpose to protest against a restriction of the life insurance business of the country to the provisions of a law which was experimental forty years ago and is to-day acknowledged by its warmest supporters to need radical changes.

There is a purpose to deny the claim, from whatever source it may proceed, that such restriction is or could be in the interest of the insuring public.

THESE PAGES ARE A PRESENTATION OF THE CLAIMS FOR REFORM AS OPPOSED TO DESTRUCTION.